BT4016 Initial Report

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We have selected Fidelity Advisor® Semiconductors Fund (FELAX) as our best mutual fund, and we have selected Berkshire Focus Fund (BFOCX) as our worst mutual fund. The reasons are as follows.

**Fidelity Advisor® Semiconductors Fund (FELAX)**

1) Industry Level (Global Chip shortage)

Fidelity Advisor® Semiconductors Fund (FELAX) is a focus fund heavily weighted in companies engaged in design, manufacture, or sale of semiconductors. This fund holds over 80% of its assets in securities in this industry. (Fidelity, Fidelity Advisor Semiconductors Fund - Class A)When the COVID-19 pandemic started in late 2019, the following global lockdowns forced chip production facilities to shut down and caused supply issues. Lockdowns also led to many who upgraded their electrical devices such as webcams, monitors and computers in order to stay in touch and work from home. In the fourth quarter of 2020, traditional computer sales saw a 26.1% growth over the previous year. (IDC, 2021) This shortage was further exacerbated in 2020, when the United States placed restrictions on the Semiconductor Manufacturing International Corporation (SMIC), China’s biggest chip manufacturer. Despite the supply shocks, the Semiconductor industry has managed to grow to $464 billion, a 10.8% increase over 2019. This makes us optimistic and we expect this growth to continue into 2021 as the supply constraints not only look to improve but many companies in the Semiconductor industry have made efforts to rebalance its chip sources and invest heavily into production and capacity, which will improve resiliency in the coming years.

2) Industry Level (New Technology/Adoptions)

2021 will be an important year for semiconductor companies as the technological shifts and innovations will fuel demand for newer and higher priced semiconductors. According to Phil Solis, research director for connectivity and smartphone semiconductors, “5G phones will capture 34% of all mobile phone shipments while semiconductors for 5G phones will capture nearly two thirds of the revenue in the segment.” There has also been growing sales of new consumer products such as new game consoles, tablets, smart home devices like Alexa or Google assistant (expected to grow 8.9% in 2021), smart watches, OTT streaming media devices (grew by 7.7%), etc. This robust growth in technological innovations and adoptions in technology requiring high end semiconductors, will continue to fuel demand going into 2021.

3) Individual Stocks: NVIDIA CORP (NVDA)

FELAX is very heavily weighted on a single company, NVIDIA CORP at 19.04% as of 31/12/2020. Nvidia has seen very strong growth in 2020, from $240 at the start of 2020 to $522 at the year end. Nvidia also announced acquisition of a UK-based chip designer arm from Japan’s Softbank Capital for $40 billion to strengthen its AI computing platform and also venture into AI research for healthcare and drug discovery. Q4 revenue was a record $2.5 billion up 10% from Q3 and up 67% from a year earlier. Bernstein analysts rated Nvidia with an outperform rating: “The company continues to over-deliver on both key segments even in the midst of a pandemic, continued supply constraints, and potential data centre digestion environment.” (Willing, 2020) Nvidia’s resiliency during the 2020 supply shocks, its strong earnings growth in quarter-on-quarter revenue as well as cash flow growth, and its commitment to R&D makes us optimistic that it will maintain its position as the leader in this field and continue to produce strong gains in 2021.

4) Individual Stocks: NXP Semiconductors NV (NXPI)

NXPI is a significant part of FELAX at 6.08% as of 31/12/2020. It is a semiconductor manufacturer that focuses on the automotive industry, with over 47% of revenue coming from the automotive industry. NXPI’s strong IOT segment is seeing strong demand, and the company is less exposed to US-China Trade war given its headquarters in Europe. (Fitzsimmons, 2020) The electric vehicle sector and related electronic components are positive catalysts for NXPI which are poised for a strong 2021 with the new US Biden Administration 2021 infrastructure plan signalling an emphasis towards clean energy and EV adoption. Additionally, COVID19 has led many companies to realize the importance of contactless technologies which require NXPI automotive semiconductors. E.g. in China, driverless cars were used for disinfecting roads as well as driverless cleaning and disinfection in hospitals or even food delivery systems. (Almario, 2020)

5) Management: Adam Benjamin

On July 1, 2020, Adam Benjamin became sole manager of the fund after having served as co-manager with Steve Barwikowski since March 2020. Adam has direct expertise in industry and has worked as a research analyst responsible for the coverage of semiconductors and related capital equipment. He has previously served as the global technology sector leader within FIAM and held various roles experience in technology equities for over 18 years. (Fidelity, Fidelity® Select Semiconductors PORTFOLIO MANAGER Q&A, 2021)Adam’s long experience in the Semiconductor research sector along with his strong returns during his asset management career leads us to believe he is a perfect fit and will guide FELAX to a strong 2021. FELAX also has a lower than average (1.24%) expense ratio at 0.72% which saves investors a significant amount in the long run.

**Berkshire Focus Fund (BFOCX)**

1. Tesla Being an Overvalued Stock

Multiple news sources from 2020 reported Tesla (TSLA) as being a heavily overvalued stock. TSLA weighs heavily in BFOCX’s holdings as its stock with the highest weightage at 6.07% and we believe that this might be one of the reasons that BFOCX might perform poorly in 2021. The primary concern over TSLA stocks is that it is reported to be “overly reliant on a [declining business of selling emissions credits](https://fortune.com/2020/09/30/tesla-profit-revenue-environmental-credits-elon-musk/) (Clifford, 2020)”. Tesla themselves expect sales of emission credits to decline eventually. As such, the performance of Tesla might dip in 2021 for the reasons stated (Kolodny, 2020).

1. Poor Forecast for Communications Services in 2021

BFOCX has a 13.21% weightage in the communications services sector, which is a large portion of their weightage in a sector that has a poor forecast for 2021. It is reported that due to the advancement of COVID-19 vaccines in 2020 (Farooque, 2020), and the possible reopening of air travel in 2021, the performance of communications stocks might slow down as people would be communicating from home less.

1. Heavily Reliant on Consumer Cyclicals

BFOCX’s highest portfolio weighting is in the consumer cyclicals sector. These are stocks that are heavily reliant on economic conditions and business cycles (Hayes, 2020). These include goods that are non-necessities such as cars, clothing, hotels and restaurants. The pandemic situation and many other global factors such as politics and war (Brush, 2020) introduces more volatility into the market such that though the market might recover, there might be a chance of another crash if the pandemic becomes worse. Consumers will start to spend more on only necessities, and this will adversely affect the prices of consumer cyclical stocks, thus affecting BFOCX’s performance.

1. Mastercard (MA) Projected Poor Performance in 2021

BFOCX holds 7.7% of its portfolio in MA. We posit that this exposure bears high risk with limited upside potential due to market conditions and the pandemic. In Q3 2020, Mastercard reported adjusted earnings per share of $1.60, which was 3% lower than estimates (www.nasdaq.com). 2020 revenue was reported at $15.3 billion, 9% lower than the previous year (www.macrotrends.net). This was likely a result of low cross border transactions due to border closures and travel restrictions (www.barrons.com). However, other competitors in the financial services industry, such as Fiserv, were recovering at a faster rate towards the end of the financial year with revenue growth of 21% in Q3 despite the pandemic. With travel restrictions and border closures unlikely to be lifted in 2021 and the poor historical performance of MA in contrast to its competitors in such market conditions, we believe that this exposure will adversely affect the performance of BFOCX.

1. Criticisms of Management

BFOCX has been under the leadership of Malcolm R. Fobes III since its inception in 1997. Throughout his tenure, it would appear that BFOCX has a tendency to perform well during bull markets and struggle proportionally in market downturns. This observation is found to have been held during the 2000-2004 bear market and subsequent rally as well as in the 2007-2010 down-and-up period (www.investmentnews.com). This poor historical performance in bear market conditions leads us to the conclusion that BFOCX will face the same troubles in 2021, with the end of the pandemic nowhere in sight. In addition, BFOCX has an expense ratio of 1.92%, significantly greater than the category average of 1.24% (money.usnews.com). We believe that this higher-than-average spending on operating expenses cannot be justified given our pessimistic outlook on their performance.

2.1 Historical Performance

Historical performance metrics are derived from <https://ycharts.com/mutual_funds>.

The calculation for sharpe ratio used is:

Historical Sharpe Ratio = (Annualized Return on Lookback Period - Risk-Free Rate) / Historical Annualized Standard Deviation of Monthly Price Returns, which is aligned to what we have learnt in the lecture. Annual return, we will be using Yahoo finance’s figures.

| **Best Fund (FELAX)** | | | | **Worst Fund (BFOCX)** | | | |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Year** | **Sharpe Ratio** | **Standard Error of Return** | **Annual Return** | **Year** | **Sharpe Ratio** | **Standard Error of Return** | **Annual Return** |
| 2020 | 1.328 | 29.47% | 43.62% | 2020 | 2.645 | 37.98% | 92.26% |
| 2019 | 2.500 | 28.96% | 63.75% | 2019 | 2.106 | 37.82% | 40.63% |
| 2018 | -0.594 | 28.97% | -12.49% | 2018 | 0.4973 | 38.45% | 10.02% |

2.2 Track record of the mutual fund manager

Adam Benjamin, fund manager of Fidelity Advisor® Semiconductors Fund (FELAX)

* Spent the past 1 year as a mutual fund manager
* Spent 10 years as a senior research analyst covering semiconductors at Fidelity Institutional Asset Management
* Before joining Fidelity in 2011, Mr. Benjamin served as managing director and head of semiconductor equity research at Jefferies & Company, Inc.
* Graduated with a B.A from Cornell University and Suffolk University Law school

Malcolm R. Forbes, CIO and lead manager of Berkshire Focus Fund (BFOCX)

* 23 years of experience as a securities analyst and a portfolio manager
* Portfolio manager of the Fund since its inception in 1997
* Serves as an Independent Director and Chairman of the Audit Committee for United States Commodity Funds, LLC
* Listed with the CFTC as a Principal of United States Commodity Funds since November 2005
* Holds a Bachelor of Science degree in Finance with a minor in Economics from San Jose State University in California

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